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Do business angels benefit their investee companies?

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Abstract

Purpose – Entrepreneurial businesses often face financial and experiential gaps, which can constrain their growth. Business angels (BAs) can provide sources of financial, human and social capital to overcome these gaps. Building on the work by Munck and Saublens, this paper aims to introduce a framework that seeks to provide a detailed understanding of the benefits that BAs can bring to the firms in which they invest.

Design/methodology/approach – In order to obtain a detailed understanding of the benefits that BAs bring to their investee companies, semi-structured, in-depth telephone interviews were conducted from an investee perspective. The key managers of nine angel-funded companies were purposefully selected and the transcribed interviews analysed with the help of common qualitative analysis techniques.

Findings – According to investee managers, BAs provide benefits in all four areas of the proposed framework. Specifically, BAs: help overcome funding gaps; fill knowledge/experience gaps through provision of their own expertise and involvement; provide a wide range of contacts and leverage further funding, including their own follow-on finance.

Research limitations/implications – The anonymous nature of the BA market requires convenience sampling, which, in addition to the small sample size used, does not allow for generalisability. The use of telephone interviews instead of face-to-face interviews did not allow for observation of non-verbal cues. Nevertheless, the study identified various areas in need of further research.

Originality/value – In-depth interview data enabled a detailed exploration of the financial and non-financial benefits of BA funding from an under-utilised investee perspective. The paper's main value, however, lies in establishing the usefulness of a framework showing BAs' benefits in a structured manner.

Keywords Management gurus, Benefits, United Kingdom

Paper type Research paper

1. Introduction

It is commonly acknowledged that small and medium-sized enterprises (SMEs) play a vital role for the economic well being of any country (De Clercq and Sapienza, 2006). This is further confirmed by the Government and Accountants Working Group (2004, p. 1), which stated "A thriving economy needs a thriving small business community." This paper focuses on high-growth businesses which are predominantly responsible

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for countries' economic development (Harding and Cowling, 2006; Smallbone *et al.*, 1995). It is therefore a major problem that young high-growth ventures are faced with a number of challenging conditions which can impact on their sustainability and growth. In particular, accessing finance can present significant challenges (Mason and Harrison, 1995). Both academics (e.g. Månsson and Landström, 2005) and practitioners (e.g. Munck and Saublens, 2003) have noted the critical role of early-stage funding in the development of high-growth SMEs. A second key difficulty for young SMEs can be their lack of human capital in terms of experience, knowledge and/or skills in managerial and business issues. Whilst the owners of young high-growth businesses may be technically well trained and have a comprehensive understanding of their products, they often do not possess the management and business skills and experiences necessary to steer the venture towards success (De Clercq and Sapienza, 2001; Freel, 1999; Mosey and Wright, 2007).

To combat these two challenges and prevent failure, a variety of public sector grants, specialised early-stage equity funds and non-financial support are available (Harrison and Mason, 1996; Mason and Harrison, 2002a; Murray, 1999). However, a private source of finance is also available to help high-growth ventures overcome funding difficulties; "business angels" (Van Osnabrugge and Robinson, 2000). In addition, business angels (BAs) may also help resolve the second major difficulty facing SMEs, that of a lack of business acumen: BAs use their own human capital in the form of skills, knowledge and experience to further their investee companies post-investment (Mason, 2006; Sætre, 2003). It would therefore appear that BAs possess the appropriate combination of prerequisites, that is, the ability to provide both funding and business expertise, and therefore the potential to help overcome both aforementioned major difficulties.

This paper investigates the benefits BAs bring to their investee companies by exploring whether BAs are able to help young high-growth firms overcome the financial and human capital challenges, which they often face. In so doing, the paper builds upon work by Munck and Saublens (2005) and particularly focuses on the experiences of nine high-growth SMEs, which have been directly involved with BAs. The paper opens by identifying the research gap alluded to earlier, before introducing a framework of BAs' benefits derived as a result of work by Munck and Saublens (2005). The methodology is then presented before discussion of the findings to emerge. The paper concludes by evaluating the benefits that BAs can bring to their investee companies, which validates the use of the underlying framework to study and analyse BAs' benefits.

2. Business angels and SMEs

BAs are private, wealthy individuals who invest their money and experience in small, unquoted entrepreneurial ventures with which they have no family connection (Deakins and Freel, 2003). The finance they provide is referred to as "informal venture capital" as, similar to formal venture capital firms (VCs), BAs typically invest money in return for an equity stake in the company (Wiltbank, 2005). The exact size of the BA market is unknown; it is characterised by its anonymous nature as BAs prefer to stay out of the public spotlight (Harrison and Mason, 1992a,b). Therefore, the cumulative amount invested and the total number of investments made by BAs cannot be determined with certainty and the following data can only be regarded as approximate.

It is estimated that there are between 20,000 and 40,000 angel investors in the UK, contributing between £0.5 billion and £1 billion in 3,000 to 6,000 businesses per year (Mason and Harrison, 2000). The literature suggests that BAs make their investments in entrepreneurial ventures due to a wide variety of motivational factors. Of these, the key factor is the potential to realise high financial returns on their investment. However, BAs are also interested in playing a role in the entrepreneurial process and earning “psychic income” (Freear *et al.*, 1995), such as the hedonistic aspects of being involved in a business or the desire to support the next generation of entrepreneurs (Mason and Harrison, 2002b).

Business angels benefit to investee companies

According to Harding and Cowling (2006, p. 116), “business angels [...] provide more than just finance for investee firms”; they can also contribute management expertise, access to networks, technological stimulation and a leveraging effect to obtain further funding. This perspective of apparent benefits is not only shared but also widened by Munck and Saublens (2005), who suggest that BAs can benefit their investee companies in four ways. They help overcome funding difficulties faced by entrepreneurial SMEs; use their human capital to provide skills and expertise to develop the firms in which they invest; use their social capital to provide their investees with access to business contacts and; ultimately increase their investees’ opportunities to acquire further finance. These four benefits, which will be detailed in greater depth in the following sections, constitute the framework for this study and are displayed in Figure 1.

Helping to overcome funding difficulties. According to Van Osnabrugge and Robinson (2000), BAs are the oldest, largest, most often used and most important source of outside funds for entrepreneurial high-growth ventures. Collectively, BAs invest between two and five times more capital in SMEs than formal VCs (Barrow *et al.*, 2005) and, whereas the literature generally suggests that BAs are a suitable and accessible source of equity funding for high-growth firms (Mason, 2002), BAs are

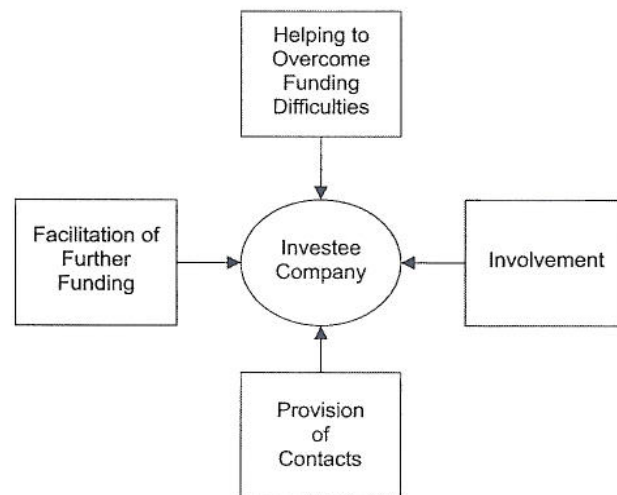


Figure 1.
Framework of BA benefits

sometimes considered to be the only group of financiers interested in investing primarily in high-growth companies facing funding difficulties (Van Osnabrugge and Robinson, 2000).

Involvement. In addition to their financial investment, BAs offer post-investment involvement (Landström, 1993), often referred to as “post-investment value adding” (Baeyens and Manigart, 2006), “contribution” (Fried and Hisrich, 1988) or “assistance” (Sapienza *et al.*, 1996). Previous research has attempted to categorise BAs’ involvement into internally homogeneous groups of activities; most often activities are classified as “active” or “passive” (Ardichvili *et al.*, 2002). Sapienza *et al.* (1996) described “passive” involvement, or the “hands-off” approach, as the provision of financial investment only. Alternatively, “active” or “hands-on” involvement describes the investor as supplying non-financial support to the investee company. The boundaries between active and passive involvement are blurred in that some scholars consider passive involvement to include monitoring of finance and operation reports, as well as involvement in strategic issues, e.g. providing strategic advice or acting as a sounding board, consultant, mentor or coach. Active BAs, in contrast, use their own knowledge, skills and experience to monitor, manage and control the investment in a more hands-on way thereby adding value to the business (Mason, 2002). Harrison and Mason (1992b) reported that few BAs monitor reports, inferring that they are involved more actively. Landström (1993) however, characterised UK BAs as rather passive, arguing that most only review reports, occasionally participate at stockholder meetings, and remain particularly reluctant to become involved on a more frequent basis. The reason for these apparent differences in findings could be explained by the difficulties in establishing the boundaries between active and passive involvement. In this study, passive involvement is defined as including the provision of funds and the monitoring of reports. All other involvement activities, no matter how hands-on they are, are classified as active involvement.

It is common for BAs to take a seat on the Board of Directors (Freear *et al.*, 1995), in this context they have access to management information and are able to participate in management decisions. A total of 60 percent of UK BAs join the Board of their investee companies (Van Osnabrugge and Robinson, 2000), but only a minority become Chairmen (Mason and Harrison, 1996). Also, those BAs who do not join the Board can actively participate in the company in many other ways. Depending on the background of the BA, they may provide a large knowledge base and expertise relating to business start-ups, as well as issues regarding commerce, industries, markets, marketing, finance and accounting. Some BAs have also been known to provide legal or organisational support (Bottazzi and Da Rin, 2002; Enterprise Directorate-General, 2002; Mason and Harrison, 1996; Munck and Saublens, 2005; Van Osnabrugge and Robinson, 2000). In general, active BAs tend to be involved strategically rather than on a day-to-day basis (Politis and Landström, 2002), however, there is evidence to suggest that some BAs are involved operationally by temporarily filling personnel gaps in the management team of their investee company. This has occurred where investee companies have lacked a well-balanced management team in the early stages of growth (Van Osnabrugge and Robinson, 2000). A small number of BAs become more operationally involved by working for their investee company as a salaried consultant, advisor or even employee. About one tenth of all BAs, described as “income-seekers”, want to be full-time employees within their investee business (Kelly and Hay, 2003).

However, even the more passive BAs are likely to become actively involved, on a daily basis, during periods when the company is experiencing difficulties (Mason and Harrison, 1996). This is not surprising as they seek to protect their investment. One of the few papers exploring the entrepreneur or investee perspective concluded that the degree of involvement is not necessarily solely dictated by investors and their personal preferences. Some entrepreneurs indicated that they preferred their BAs to be actively involved, whereas others preferred much less involvement as they considered involvement to be intrusive and counterproductive (De Noble, 2001).

Provision of contacts. In addition to skills and experience, young companies often lack social capital such as business contacts and access to appropriate networks (Davidsson and Honig, 2003; Fredriksen *et al.*, 1990). Therefore the provision by BAs of their social capital, i.e. their personal networks, can further their investee companies (Mason, 2002). Depending on their individual backgrounds, some BAs introduce management contacts and connections in the industry or recruitment contacts; that is, they recommend executive and non-executive directors. Others facilitate relations with potential customers and external organisations such as research institutes or universities and also promote alliances (Ehrlich *et al.*, 1994; McKeon, 1996; Munck and Saublens, 2005; Sapienza and Timmons, 1989). Additionally, most BAs are able to provide an array of contacts in the investment community, often introducing other BAs to the company or recommending their investee companies to other sources of finance (Cary, 1994). This benefits the investee, not only through access to additional contacts, but also through the possibility of raising further financing (Sørheim, 2005).

Facilitation of further funding. Companies backed by the investment of one or more BAs become more attractive to other sources of capital. This so-called “leveraging effect,” created by BAs, increases the chances of BA-funded companies to raise capital from additional sources – banks, VCs or other private investors – at the same time as the initial investment or later in subsequent funding rounds as the business develops (Harding and Cowling, 2006; Sørheim, 2005). This leveraging effect can be explained by the presence of BAs creating confidence in the business and increasing its credibility with other equity investors (Munck and Saublens, 2005). Moreover, BAs are useful for VCs as they can share due diligence efforts and costs and can reduce ongoing running costs for VCs through their involvement and the provision of their experience (Harrison and Mason, 2000). In terms of debt finance, BA-investments build a strong balance sheet with an improved debt-equity ratio, reducing the risk for lending institutions and therefore allowing borrowings (Van Osnabrugge and Robinson, 2000). It is not just the investment BAs make but also their personal involvement in the business, which aids the investee in future fundraising. Debt and equity financiers accept that there is an increased investment readiness on the part of the investee, owing to the BAs’ provision of their skills and experience (Munck and Saublens, 2005). Investees may further benefit from follow-on funding in subsequent financing rounds provided by BAs who already possess equity stakes in the company. However, the literature is inconclusive as to the extent to which BAs provide follow-on finance: some authors are in agreement (Coveney and Moore, 1998), others reject the idea. For example, Mason and Harrison (1996) indicated that only a quarter of BAs invest in more than one subsequent round.

In spite of the importance of BAs for the survival and development of young high-growth businesses, most previous research effort has focussed on investigating formal VCs, including many studies into VCs’ involvement and their benefits to

investees (e.g. Rosenstein *et al.*, 1993). Additionally, much prior research has studied the perspective of the investor (e.g. Paul *et al.*, 2007). This paper addresses this gap in BA literature by investigating BA benefits for their investee companies from the investee perspective. In so doing, the use of the structured benefits framework, built upon Munck and Saublens' (2005) work, adds particular value to the previously rather unordered and atheoretical nature of BA research (Harrison and Mason, 1999).

3. Research methodology

Aims and importance of the study

The purpose of this study is to explore how investee companies can benefit from their business angel investors. To explore this, a series of four research questions, informed by the above discussion of the benefits framework were developed:

- (1) Are BAs able to overcome young businesses' funding difficulties?
- (2) In what ways are BAs involved in investee companies during the post-investment period?
- (3) Do BAs provide their investees with contacts and if so, what is the nature of these contacts?
- (4) Do BAs facilitate the acquisition of follow-on funding for their investee companies?

This research adds unique and important insights to the existing BA literature for several reasons: the investee perspective complements the existing investor-focused literature (De Noble, 2001), whilst the use of semi-structured interviews adds an in-depth exploration to the current knowledge of BA benefits, which has been derived mainly from survey data (Ehrlich *et al.*, 1994; Landström, 1992). Furthermore, this study addresses the lack of research on post-investment issues (Kelly, 2007; Macht, 2006), validating the findings as an important contribution to the overall picture of BA investments.

Research design and data collection

The study aims to explore the benefits that BAs can bring to investee companies and requires the collection, in detail, of opinions and experiences. Thus semi-structured, in-depth interviews were deemed an appropriate method of data collection and due to monetary and time constraints, telephone interviews were selected (Sturges and Hanrahan, 2004). A vivid debate exists in relation to the value of less personal methods of communication such as telephone or electronic interviews (Morgan and Symon, 2004). Some researchers consider telephone interviews inferior to the traditionally applied method of face-to-face interviewing as the telephone conversation does not allow the researcher to observe and analyse any visual, informal or non-verbal cues (Miller, 1995). Other researchers consider telephone interviews to be equally valuable. For example, Sturges and Hanrahan (2004) claim there are no differences in the quality and depth of data collected via both methods of interviewing and that non-verbal cues (such as sighs or pauses) can still be detected over the phone. For the purpose of this study, the authors have adopted Sturges and Hanrahan's (2004) approach and used telephone interviews as the main method of data collection. In addition, telephone interviews were the only option available to access some of the respondents

(time-constrained entrepreneurs) who were only willing to commit to this method of interview.

Due to the secretive nature of the angel market, there are no lists or directories of angel-backed businesses available (Van Osnabrugge and Robinson, 2000). Therefore, without the help of intermediaries (Business Angel Networks or BANs), it is highly unlikely that researchers could identify angel-funded companies. Several BANs in the UK were contacted and their assistance sought via email in November 2004, with subsequent follow-up phone calls in January and February 2005. One of the authors worked on a secondment basis for an angel intermediary in January 2005, which provided further access opportunities. Due to the lack of knowledge surrounding the size of the angel market and the preferred anonymity of BAs, researchers have to rely upon "convenience sampling" to a certain degree; only those contacts who were conveniently provided by and accessible through BANs were included in the selection process (Freear *et al.*, 2002). In order to obtain a broad range of opinion on the benefits of BAs, a purposeful sampling design (Creswell, 1994) was applied and companies operating in different industries, geographical areas and stages of development were contacted. Nine directors of angel-funded businesses agreed to participate in the research and telephone interviews were conducted between January and March 2005.

Directors participated in between one and three interviews with each interview lasting between 20 and 90 minutes. Interview data was complemented by occasional written correspondence. Participants were either managing directors or other key members of the management team who were involved with both the decision to take BAs on board and post-investment involvement. Table I presents an overview of the interviewees and their businesses in an anonymised form.

In order to best achieve the aim of answering the research questions relating to BAs' benefits, it was important to use the four-component framework described above as a guide to data collection. Thus, interview questions were broadly related to the framework. Questions were open-ended giving respondents the opportunity to develop their answers and to provide narratives as broad as they deemed appropriate. Interviewees were not interrupted when answering questions; they were given every opportunity to build upon and explain their views and experiences openly and in depth (Marshall and Rossman, 2006). Occasional probing led the respondents back to the question had their answer begun to stray (Curran and Blackburn, 2001).

Data analysis

All interviews were digitally recorded allowing the production of a verbatim transcript, including the interviewer's thoughts and comments. Subsequently, common techniques of analysing qualitative data were applied: reading and re-reading the transcripts while writing analytical memos facilitated coding of the data and the subsequent development of monothematic themes from phrases and other parts of data occurring in the interviews (Easterby-Smith *et al.*, 2002; Shaw, 1999). These emerging themes were allocated to appropriate research questions and thus to their respective components of the BA benefits framework. Using the framework to guide analysis, the researchers were able to focus on only those aspects of the data, which were relevant to achieve the objectives set out by this study (Silverman, 2000). This method of data analysis ran simultaneously with data collection and was then reviewed once all interviews were completed (Creswell, 1994). In addition to matching themes to research

Table I.
Summary of research
participants

Investee ^a (year founded)	Interviewee (number of interviews)	Industry	Time of investment	Stage of the business
Alpha (2000)	Managing Director (MD) (1 interview)	Internet retail	2000	Directors only had a concept
Beta (1998)	MD (3 interviews)	Security and services	2002 2003 1998 Four rounds between 1998 and 2005	Company has started to trade Business was growing Seed financing Development capital
Gamma (1998)	Financial Director (2 interviews)	Pharmaceutical/bioscience	May 2003 until December 2004	R&D stage
Delta (2004)	Business Development Director (1 interview)	Diversity training	September 2004	Money needed for marketing and selling the product
Epsilon (2004)	MD (1 interview)	Parking	September 2004	Start-up: money needed for further sales
Zeta (2001)	MD (1 interview)	Medical devices	End of 2002	Company traded, but below break-even
Eta (2002)	MD (1 interview)	Software development	April/May 2004	Early stage
Theta (2002)	MD (1 interview)	Fuel cells	June 2004	Early stage, pre-sales
Iota (2003)	MD (2 interviews)	Leisure	October 2003	Non-trading concept

Notes: ^aFor anonymity and confidentiality reasons, the names of the companies were disguised

questions the emerging themes were used for comparison across interviews (Shaw, 2006). Furthermore, relationships and patterns between themes were analysed and, using some of the data underlying the themes, compared and contrasted to the literature (Easterby-Smith *et al.*, 2002; Shaw, 1999). Table II details the emerging themes in relation to the individual research questions to which they have been allocated.

4. Interview findings and discussion

The following results are presented in the form of the framework detailing the four main benefits of BAs as explained in the literature review above.

Helping to overcome funding difficulties

Only three participating firms were able to obtain formal VC funding (Iota, Epsilon and Gamma). Four firms approached VC institutions but failed to secure capital. The remaining two businesses did not approach VC firms due to their opinion that they were too rigorous in terms of meeting funding criteria:

We approached quite a few small venture capital firms as well and we talked to them over the whole period, maybe 15 different investment institutions of one sort or another and we have not got any money out of them (Alpha).

The lack of willingness to even approach VCs, which was displayed by two of the interviewees, is based on a negative perception of, and attitude towards, these “vulture capitalists” (Rosenstein *et al.*, 1993).

Three investees were able to raise debt finance (Iota, Delta and Zeta) but stated that they faced severe difficulties in obtaining this type of funding. Four of the remaining businesses approached loan providers but failed to raise funds:

It is impossible to obtain debt finance. At the beginning, we could not get any debt finance at all (Gamma).

It is not surprising that most interviewee businesses were unsuccessful in obtaining finance from formal VCs or debt providers, considering the well-known reluctance of these types of investors to commit funding to young high-growth businesses (Landström, 1993; Baeyens and Manigart, 2006).

All directors admitted to having funding difficulties and agreed that BAs were a way of overcoming these problems. Some of the directors even articulated that their company would not exist had the BAs not provided investment. The participants corroborated the view held by the literature that BAs enable investees to surmount their funding difficulties (Mason, 2002), clearly demonstrating that BAs can benefit their investees in this way. The notion that some of the companies would not exist without the investment of their BAs supports the assumption that BAs are the main – and possibly the only – financiers investing in early-stage high-growth businesses (Van Osnabrugge and Robinson, 2000). Additionally, the businesses’ attitude is more positive towards BAs than towards VCs, which points to the conclusion that BAs also benefit their investees through being perceived as more appropriate investors than VCs (Mason and Harrison, 2002c).

Involvement

Only three interviewees explicitly indicated that they frequently and regularly send reports such as financial statements to their BAs. This supports Harrison and Mason’s

Theme	Example of raw data, based on which themes emerged
<i>Benefit 1 (RQ1): Helping to overcome funding difficulties</i>	
Difficulties to raise equity	The equity gap “is anything between seed-financing, right the early stage, I would say right up to £1.5 million, £2 million. There are not enough possibilities for small businesses to obtain equity money” (Beta)
Difficulties to raise debt	“We had to present to three different, separate banks. [. . .] We had to present to them and we needed a business plan to convince them that they could get the money back. So, yes, it was laborious” (Delta)
Funding vehicles approached	“At that time, we had no revenue income and we had nothing to fund any debt with. Now that we have income and other moneys, we can incur debt. But a year ago, this was not possible” (Gamma)
Usefulness of BAs to bridge funding gaps	“We approached quite a few small venture capital firms as well and we talked to them over the whole period, maybe 15 different investment institutions of one sort or another and we have not got any money out of them. It was all private individuals” (Alpha)
<i>Benefit 2 (RQ2): Involvement</i>	
Passive involvement	“We do six-monthly reviews where I present the performance and the business plans and that is quite a good discipline to have anyway” (Zeta)
Active involvement	“All of them are on the Board. They also have to be. They need to have a say” (Epsilon)
BAs’ human capital	“They all brought different skills, different experiences. It is a well-balanced Board” (Eta)
BAs’ responsiveness	“When the business came across hard times, he was finding himself driving there two or three times a week” (Iota)
BAs’ investment motivations	“The opportunity to make money, the ROI. The Return on Investment of our business has a lot of potential” (Beta)
MDs’ human capital	“In my opinion, regardless of what the business type is, as long as you have got strong leadership and the right management skills, you can run any business” (Beta)
MDs’ receptivity	“The BAs who were to be on the Board had to have some commercial experience and contacts” (Gamma)
<i>Benefit 3 (RQ3): Provision of contacts</i>	
BAs’ social capital	“[. . .] contacts for printers for brochures. Fairly minor things, to be honest, but still quite useful” (Zeta)
MDs’ social capital	“We have already had most of what we needed” (Alpha)
<i>Benefit 4 (RQ4): Facilitation of further funding</i>	
Provision of own follow-on funding	“I think my angels will give me finance in further stages” (Epsilon)
Leveraging effect for equity	“As soon as you have a few people investing in it, this encourages other people to invest” (Delta)
Leveraging effect for debt	“After I really had secured the interest of the venture capital and the business angel, the loan seemed to happen quite quickly” (Iota)

Table II.
Summary of key themes

(1992b) findings that only a few UK-based BAs monitor reports. However, the importance that these three interviewees attached to the passive monitoring of reports calls for additional scrutiny of this theme: the need to send out regular reports to their angel investors forced the interviewees to be disciplined (Zeta) and accountable (Theta), which brought about a professional edge to the business, necessitating MDs to focus on management issues (Beta). Hence, the need to send regular reports to BAs was seen as a significant contribution. Even though the literature has referred to this involvement as "monitoring of reports" (Gomez-Mejia *et al.*, 1990), the activity of issuing them to BAs is not actually being executed by the investors. Thus, it is plausible to assume that the remaining six companies also provided their investors with reports although they did not explicitly state this. One potential explanation is that the interviewees did not consider the issuing of reports to BAs as an investor involvement activity and thus it did not occur to them to mention this activity. An alternative explanation is the possibility that investee directors perceive the provision of financial statements and other reports to their BAs as too obvious to mention.

As with most other angel-funded companies, all interviewees had at least one BA on their Board of Directors (Freear *et al.*, 1995). Similar to Mason and Harrison (1996), in one third of the companies a BA was also the Chairman who managed not only the company but also the Board and represented the other investors as well (Beta, Eta and Theta). In all participating companies, Board members and Chairmen discussed strategy with the management team and contributed to decision-making, which reinforced BAs' strategic involvement in their investee companies (Politis and Landström, 2002). Only Alpha mentioned overtly that its BA gave strategic advice, however, some of the other companies admitted that their BAs encouraged them to focus on the "big picture" (e.g. Beta); this can be considered as being strategic involvement. All directors mentioned that their BAs contributed their personal experience in their roles as advisor or mentor in general business issues, again supporting the notion that BAs are strategically involved. The following statement further depicts this:

As most of our business angels only invest their money, without being involved in anything regarding our company, I cannot tell you much about active involvement. However, two of the bigger investors sit on the Board. They are Directors of the company. And they help us. We discuss strategy with them, so they make a contribution (Alpha).

Many of the participants claimed that their BAs did not have any experience in the industry in which their investee companies operated and therefore, other studies' conclusion that BAs contribute their experience and knowledge to their investee's industry (Kelly and Hay, 2003) cannot be confirmed in the findings of this research. This would particularly apply to those businesses operating in newly created industries, whereby it would be impossible for any investor to possess experience. Nevertheless, the lack of industry-related experience on the part of the BAs further highlights their propensity towards strategic involvement, as such contributions would require general business acumen rather than industry-specific experience (Mason and Harrison, 1996).

In spite of the above-mentioned focus on strategic involvement, eight of the companies had BAs who became very actively involved in various unique situations: one BA worked on a consultancy basis for the company installing an accounting system (Alpha); other BAs participated in working groups relating to IT issues

(Epsilon) and workshops in order to focus the management on a broader picture (Beta); one BA participated in meetings in order to make the company appear larger with more members of staff (Delta); another negotiated access to further equity with venture capital institutions (Iota) and another participated at investment meetings, influencing other investors' opinions positively towards the company (Beta). Some BAs provided accounting, legal or financial support, others conducted research – for example concerning trading shares (Delta) – or even undertook the bookkeeping for their investee companies (Epsilon). Despite most BAs becoming active in a number of specific situations, they did not become actively involved on an operational, day-to-day basis; none of the BAs became employed within the investee company and – although Beta's MD admitted that they occasionally took advantage of their BAs' skills in order to delay having to employ new members of staff – no BAs officially filled any personnel gaps in the management team over longer periods of time. This again emphasises the strategic nature of involvement, in that the vast majority of active involvement solely concerned unique events, which is a commonly known characteristic of VCs rather than BAs (Fried and Hisrich, 1995). The particular benefit of BAs' more active involvement in their investee companies can be summarised by a comment from Beta's director, who reported that the experience of BAs 'rubs off' on the management team and therefore increases their own experience. The literature has acknowledged this potential for investees to learn from their investors, although this requires a willingness to be receptive to the involvement on the part of the investee (Murray, 1996).

This need for receptivity and responsiveness from investees might even be considered to be one of the reasons for the lack of more ongoing active involvement identified in this study (Barney *et al.*, 1996). Probing the participating companies about whether they would have preferred more active investors resulted in a unanimous agreement that they wanted passive investors; investing their money, but not getting too involved or interfering with the management of the business. Five firms mentioned the importance of management running the business, not the investors:

I want to run my own business without someone interfering (Alpha).

Despite wanting rather passive investors, all directors stated that they were not purely interested in the financial funds provided by their BAs. All interviewees agreed that they wanted their BAs to be responsive and supportive if they had cause to seek their help (Kelly and Hay, 2001):

Our business angels were not active on a day-to-day or executive point of view, but certainly responsive to requests. And supportive (Theta).

The finding that none of the participating directors sought active investors can be explained by the directors' own level of experience and willingness to learn from the BAs' involvement. All of the directors participating in this study claimed to be very experienced businesspersons who had set up and successfully run other businesses previously and therefore did not need a lot of active support from BAs, particularly considering that the participants' BAs do not possess sufficient industry expertise to contribute to the business (Kelly and Hay, 2001).

Considering that the investee company directors did not want their BAs to be overly active, they were questioned as to whether they were aware of their investors' desire to

become involved. In order to identify this, the interviewees were asked to express – to the best of their knowledge – what factors motivated their BAs to invest in their businesses, a question based on existing research, which suggests that BAs are primarily motivated by a potentially high financial return on their investment, whilst also possessing very strong secondary non-financial, psychic motivations (Barrow *et al.*, 2005; Ehrlich *et al.*, 1994). The responses suggest a relation between the investment motivations of BAs and their degree of active involvement: all participants stated that the primary motivation for their BAs was financial return, while none of them mentioned participation in entrepreneurial processes as a main motivating factor. These comments suggest that not only do the entrepreneurs not want their BAs to become very active, but they perceive that BAs are not interested in being involved in an overly active way; that they are more concerned with gaining a sufficiently high return on their investment. Consequently, this study found that BAs, whose principal motivating factor is return on investment, do not become actively involved to a great extent. However, the company directors wanted their BAs to be responsive and supportive if the business required their help; in order to protect their investment and thus their investee, BAs were expected to become active in order to avoid a drastic decrease in possible financial return. Whilst not explicit, this study implies that BAs who are solely motivated by return can still become incentivised to be actively involved in their investee companies, if that involvement can support their major goal of a substantial return (Landström, 1992). It should be noted however, that the account of the motivational factors is based on the opinion of investee company managers and it therefore cannot be claimed with any certainty that it mirrors the BAs' views.

Provision of contacts

Since most of the participating directors were experienced and working in complete management teams they were assumed to already possess a broad social capital base with many useful business contacts or to be members of valuable business networks (Alsos *et al.*, 2006). Yet, the BAs of the participating companies provided their investees with a number of different business contacts, see Figure 2.

The listings demonstrate the wide range of contacts made available to investee companies. They also include those contacts that BAs attempted to procure for the

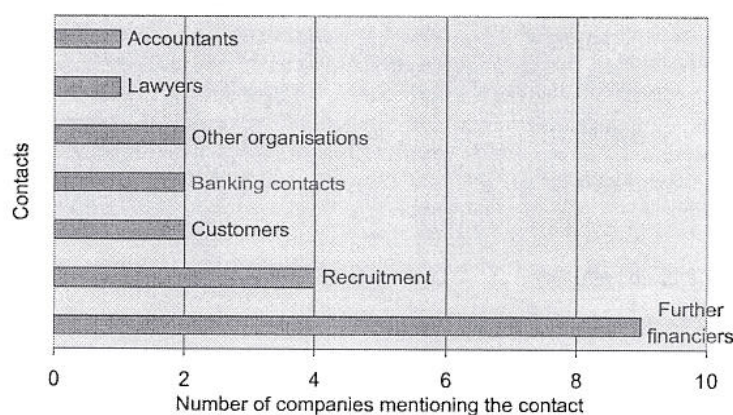


Figure 2.
Contacts with which the interviewees' angels were helpful

company but were unsuccessful. This happened particularly in terms of recruitment: some BAs provided companies with the CVs of potential candidates (e.g. Beta) or recommended directors (e.g. Theta) but appointments were not made. The category of "further financiers" includes formal VCs, as well as other BAs. A few companies revealed that BAs were helpful in establishing contacts with "other organisations", e.g. companies eligible to enter into alliances (Beta) and service providers such as promotional materials printing (Zeta). Another specific example of contacts provided was introductions to lawyers and bankers in developing countries (Gamma). Furthermore, one of Theta's BAs was the Chief Executive Director of one of its major UK customers. All of the above examples suggest that the participating investee managers consider BAs' provision of contacts as an important contribution to their investee companies. This further confirms existing literature, which argues that providing contacts is an important way in which BAs can benefit their investee businesses (Ehrlich *et al.*, 1994; McKeon, 1996; Munck and Saublen, 2005; Sapienza and Timmons, 1989).

In addition to the benefits derived from the wide range of contacts provided by BAs, the interviews further contributed original insight regarding additional ways in which investee companies can benefit from BAs' contact provision: even on occasions when investee managers are already members of numerous and varied business networks and tend to be able to obtain necessary contacts themselves, BAs can still provide benefit in two distinct ways. First, BAs can initiate contact faster as they are close to their contacts and may not need to go through a number of distantly related acquaintances; according to Beta this enabled management to work more efficiently. Second, where BAs provide contacts, investee companies do not have to incur any agency or service provider costs. Beta's MD summarised this eloquently:

If I want to approach a particular organisation [...], I can do so by simply putting an email up to my investors and they will come back with a contact. Obviously, that saves an awful lot of time and awful lot of efforts.

Facilitation of further funding

All companies unanimously agreed that the investment of BAs can have the effect of initiating further additional sources of funding. Therefore, the investee companies confirmed the existence of a leveraging effect – of both debt and additional equity – as expressed in the BA literature (Harding and Cowling, 2006; Sørheim, 2005). The reasons for the leveraging effect of both types of funding can be summarised as follows: the amounts invested and the pure presence of BAs as investors in the company creates credibility and increases the confidence of external parties in the business (Mason and Harrison, 1996). The interviewees mainly explain this by claiming that BAs committing their own money is "a vote of confidence" for the business, which substantially adds to the company profile. This vote of confidence can even increase the business's chances of additional funding if the existing BAs are well networked in investment circles and recommend and promote their investee to other potentially interested investors (Haar *et al.*, 1988). This often facilitates a snowball effect:

If one of them is interested, normally they know at least one other who would also be interested (Theta).

Increased confidence, combined with the effect of BAs' investments improving a business' balance sheet position, enables investees to access debt finance which would not be

possible without the reduced gearing (Van Osnabrugge and Robinson, 2000). In this study, the three companies that managed to borrow capital (Iota, Delta and Zeta) were only able to do so because they had secured equity from BAs based on the above reasons.

More than BAs' financial investment, their experience and involvement can especially help investees to obtain additional funding (e.g. Theta's BA helped the business float on AIM and one of Eta's BAs had extensive experience of growing companies and public prospectuses). The findings show that the investee companies believed that their BAs made them more attractive to other equity investors. The two companies that had already been able to raise formal VC were good examples demonstrating that BAs are able to leverage other sources of equity. Gamma was only able to raise VC after having obtained support from BAs. The literature argues that this equity-related leveraging effect stems from VCs' reduced costs because they can rely on the BAs' involvement as a control mechanism (Harrison and Mason, 2000), but the comments provided by the interviewees in this study rather view the BAs' contacts and creation of credibility as the main reasons for the leveraging effect. The following comment from Iota's MD illustrates this:

In my own experience, the guy who invested in me brought a lot of traction with him. He had extensive contacts in the venture capital world and syndicates of other angels.

The literature is inconclusive about whether BAs give follow-on finance themselves. One third of the companies in this study had received follow-on finance from some of their existing BAs in more than one subsequent round:

We had some investors who have done every single finance round (Beta, which had five rounds of finance).

Other BAs had not yet invested in more than one round, but their investee company directors were confident that some of them would do so in subsequent funding rounds:

Our business angels have not yet provided follow-on finance, because we have only had our first round of financing, but about 20 to 30% of them want to give us more funding in following rounds (Gamma).

Therefore, this study agrees with Mason and Harrison (1996) who posit that only a minority of BAs invest in more than one subsequent round, however, the fact that some of the interviewees' BAs have not yet had the chance to provide follow-on finance has to be acknowledged as a limitation to this finding.

5. Summary and conclusion

Research related to BAs lacks extant literature and theoretical foundations (Harrison and Mason, 1999; Phan, 2004). In order to add to the literature, the purpose of this study was to investigate empirically and in-depth, investees' opinions on the potential benefits to be gained from BAs. These benefits have been organised into a four-component framework which was used to guide data collection and analysis. These four benefits are:

- (1) Helping to overcome funding difficulties.
- (2) Involvement.
- (3) Provision of contacts.
- (4) Facilitation of further funding.

The findings discussed in this paper confirm these four benefits and are summarised below in response to the research questions posed:

RQ1. Are BAs able to overcome young businesses' funding difficulties?

BAs invest in young high-growth companies, which – in spite of approaching both debt and formal equity providers – have not been able to raise funds from any other source. Therefore, the investees owe their existence to the investment of their BAs and with their help are capable of continuing to operate and grow. This points to the conclusion that BAs benefit their investees by helping them overcome their funding difficulties (Barrow *et al.*, 2005; Van Osnabrugge and Robinson, 2000).

RQ2. In what ways are BAs involved in investee companies during the post-investment period?

BAs are involved in their investee companies in many different ways and to varying degrees. They use their experience, skills and expertise when being passively and/or actively involved in the business. Both types of involvement can benefit the investees; passive monitoring of reports can for example establish disciplines, whereas more active involvement, such as sitting on the Board of Directors or involvement during unique situations, allows BAs to draw on their own experience, from which investee managers should ideally learn and increase their own experience base (Fried and Hisrich, 1995; Murray, 1996). However, investees' receptiveness to input and their willingness to seek involvement play a major role in BA involvement (Barney *et al.*, 1996).

RQ3. Do BAs provide their investees with contacts and if so, what is the nature of these contacts?

BAs place their own network of business contacts, which are often varied and wide-ranging, at the disposal of their investee companies (Ardichvili *et al.*, 2002). This provision of contacts benefits investee companies as they can access a broader network base if required, quickly and efficiently.

RQ4. Do BAs facilitate the acquisition of follow-on funding for their investee companies?

BAs have a leveraging effect upon their investee businesses: due to a BA investment, other financiers – both equity and debt providers – become interested in the company and invest (Harding and Cowling, 2006; Sørheim, 2005), mainly due to the credibility and confidence that BAs' investment and involvement create (Munck and Saublens, 2005). This credibility – combined with the development of a strong balance sheet, BAs' recommendations to other investors and their own follow-on finance – benefit investees through the direct or indirect provision of additional financial resources.

The value of this study lies in its ability to complement previous research and to contribute original insights to the current BA literature. First, it enhances previous research by introducing the investee-perspective to a research area, which is characterised by a strong focus on the viewpoint of BAs (e.g. Sørheim, 2005). In so doing, the study demonstrates that investment recipients recognise the benefits of BAs as illustrated by the benefits framework. This adds to the investor-focused literature, which studies investors' perceptions of their own benefits. Second, the study used

in-depth telephone interviews to explore investees' views in a comprehensive manner, building on the findings of extant research developed mainly from survey data (Ehrlich *et al.*, 1994). Third, it brings to light a range of avenues for further research which would not have been identified had any other research design been applied (see below). Fourth, and most importantly, it presents a framework that enables a structured investigation of four major benefits that BAs can provide to their investee companies. The particular usefulness of the framework has been validated in light of the investees' comments and the themes emerging from them.

This study has a number of limitations, which have to be taken into consideration when assessing its value. The findings are biased in that the companies are managed by experienced entrepreneurs whereas in reality, many entrepreneurial ventures are run by management teams who are *inexperienced*. Had the interviewees belonged to the latter group the results might have been different, especially in terms of need for, and acceptance of, involvement. BA research can never be verifiably representative due to the anonymous nature of the angel market (Harrison and Mason, 1999). This feature justifies the application of convenience sampling but at the same time does not allow generalisations over the entire population especially as the sample size in this research was very small (Brannen, 2005). On the other hand, the authors managed to gain considerable insight into the interviewees' opinions and attitudes. The authors were also obliged to accept the information given to them without being able to validate it by means of further research, e.g. by triangulating data from other sources (Jick, 1979). As previously explained, telephone interviews were the only available method of data collection for this particular project, however, some researchers would condemn this as a limitation. The authors acknowledge this potential drawback, whilst being aware that many researchers uphold the value of telephone interviewing.

This research should be replicated using a larger sample in order to achieve a more representative account of the investee company's view of the benefits of BAs. One further suggestion is to interview matched BA-investee dyads regarding their perception of the benefits they offer, in order to confirm the results of the study from the company perspective or to explore differences in perceptions. This paper was not based on a specific theoretical framework due to a lack of theories in the BA discipline. Using a framework such as the one applied in this study constitutes a valid initial step towards a specific theoretical model, but researchers have to develop suitable and applicable theories in order to move away from overly empirical research. This could perhaps be achieved by expanding upon and refining this study's framework during further inductive theorising. As the use of telephone interviews can be viewed as a shortcoming, this study should be replicated using face-to-face interviews, where the interviewer should pay particular attention to visual and non-verbal cues during the respondents' narratives in order to identify any potential meaning therein. Nevertheless, the study has illuminated a number of areas that require further investigation. Some interesting emerging themes which should be further explored are: the determinants for company managers to prefer their BAs to be passive or active; where investee managers perceive the boundary between passive involvement, active involvement and interfering; and whether other finance providers acknowledge BAs' leveraging effect. Since this study is part of a larger, ongoing research project exploring mainly the post-investment involvement of BAs with their investee companies, some of the above-mentioned recommendations are already being pursued.

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